

# THE YALE LAW JOURNAL

## COMMENT

### Balancing Burdens: Clarifying the Discovery Standard in Arbitration Proceedings

As litigation costs rapidly rise, the United States needs a just and effective, but lower-cost, manner to resolve disputes. For years, arbitration has been that alternative.<sup>1</sup> Unfortunately, recent disagreement among the circuits on the scope of arbitrators' authority to compel testimony or document production as conferred by the Federal Arbitration Act (FAA)<sup>2</sup> threatens to undermine the desirability and efficacy of arbitration resolution.<sup>3</sup> When there is uncertainty as to the ability of parties to obtain and analyze information prior to a hearing, contracting parties may perceive arbitration as an unjust or ineffective manner for resolving disputes, and thus will likely not opt in to arbitration proceedings. This may be particularly acute in industries, such as health insurance or reinsurance, in which critical information often resides with nonparties. As parties shift from arbitration to litigation, the overall costs of enforcing their contracts will increase, which will cause the gains from each contract to fall, suggesting that the marginal contract will not be made. To keep arbitration as an effective mode of dispute resolution and maximize the number of efficient contracts made, this procedural issue must be resolved. Congress must take action to clarify the scope of arbitrators' authority and empower them to issue enforceable nonparty subpoenas for prehearing

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1. For an overview of the criticisms leveled against arbitration, see David Sherwyn, *Because It Takes Two: Why Post-Dispute Voluntary Arbitration Programs Will Fail To Fix the Problems Associated with Employment Discrimination Law Adjudication*, 24 BERKELEY J. EMP. & LAB. L. 1, 22-30 (2003).
  2. 9 U.S.C. § 7 (2000).
  3. See, e.g., W. Scott Simpson & Omer Kesikli, *The Contours of Arbitration Discovery*, 67 ALA. LAW. 280 (2006).

proceedings. Although either creative contracting or a Supreme Court opinion could resolve this dispute, Congress is best positioned to balance the desire that parties reach the ideal outcome with the need not to overburden nonparties, while preserving the relaxed procedural requirements that make arbitration appealing.

## I. DEFINING THE PROBLEM

To fully understand the need for congressional action, one must first understand the doctrinal difficulties of § 7, which states, “The arbitrators . . . may summon . . . any person to attend before them or any of them as a witness and . . . to bring with him or them any book, record, document, or paper which may be deemed material as evidence in the case.”<sup>4</sup> As mentioned above, the circuit courts have disagreed on the correct interpretation of this language.

The Third Circuit in *Hay Group, Inc. v. E.B.S. Acquisition Corp.* held that arbitrators have no authority to compel nonparties to produce documents prior to arbitration hearings.<sup>5</sup> Then-Judge Alito noted, “An arbitrator’s authority over parties that are not contractually bound by the arbitration agreement is strictly limited to that granted by the Federal Arbitration Act.”<sup>6</sup> To understand the scope of authority the FAA created, the court stated, “we must, of course, begin with the text.”<sup>7</sup> Using this textual approach, the court interpreted the phrase “to attend before them . . . and . . . to bring with him or them any book” to “speak[] unambiguously to the issue.”<sup>8</sup> The court held that the careful use of the phrase “to bring with him” applies only to items physically brought with the nonparty to a hearing before the arbitrators, “not to situations in which the items are simply sent or brought by a courier.”<sup>9</sup> The court also noted that the drafters’ use of “and” unambiguously limits the arbitrator’s subpoena power to situations in which the nonparty will appear before the arbitration panel.<sup>10</sup> To support its holding that the drafting reflects some intention to limit the subpoena power of arbitrators, the court highlighted several state statutes that provided equally unambiguous authorization of such power.<sup>11</sup> Based on these

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4. 9 U.S.C. § 7.

5. 360 F.3d 404, 411 (3d Cir. 2004).

6. *Id.* at 406.

7. *Id.*

8. *Id.* at 407.

9. *Id.*

10. *Id.*

11. *See id.* at 407 n.1.

pieces of evidence, the Third Circuit concluded that the text unambiguously did not authorize any discovery subpoena power for arbitrators.

Despite the “unambiguous text” of § 7, the Eighth Circuit came to a different result when presented with a similar question.<sup>12</sup> In *In re Security Life*, the Eighth Circuit acknowledged that § 7 “does not . . . explicitly authorize the arbitration panel to require the production of the documents for inspection by a party.”<sup>13</sup> Nevertheless, it held that there was an *implicit* power to subpoena documents for discovery.<sup>14</sup> Unlike the Third Circuit, which restricted its interpretation to the text, the Eighth Circuit drew on the goal of efficiency in dispute resolution. The court conceded that “the efficient resolution of disputes through arbitration necessarily entails a limited discovery process,” but it also recognized that “this interest in efficiency is furthered by permitting a party to review and digest relevant documentary evidence prior to the arbitration hearing.”<sup>15</sup> After announcing this holding, the court suggested in dicta that this implicit power was appropriately used in this particular case because “[the nonparty] is not a mere bystander pulled into this matter arbitrarily, but is a party to the contract that is at the root of the dispute.”<sup>16</sup>

Intermediately, the Fourth Circuit in *COMSAT Corp. v. National Science Foundation* held that courts may enforce arbitral subpoenas for prehearing proceedings only in the case of demonstrated “special need.”<sup>17</sup> Like the Third Circuit, the court in *COMSAT* began with a strong textual approach. The court found, by § 7’s own terms, that “the FAA’s subpoena authority is defined as the

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12. *Sec. Life Ins. Co. v. Duncanson & Holt, Inc. (In re Sec. Life Ins. Co.)*, 228 F.3d 865, 870-71 (8th Cir. 2000). The Eighth Circuit nearly addressed the distinction between arbitrators’ authority to compel document production and deposition attendance. The court, however, vacated the question as moot because the party challenging the subpoena had already complied with the request. *Id.* at 870. No other circuit court has squarely answered this question. Some district court opinions and commentators agree that there is a significant qualitative difference between requests for prehearing document production and depositions. See *Proctor & Gamble Co. v. Allianz Ins. Co. (In re Proctor & Gamble Co.)*, No. 02-5480, 2003 U.S. Dist. LEXIS 26025 (S.D.N.Y. Dec. 2, 2003); Simpson & Kesikli, *supra* note 3. The Fourth Circuit in *COMSAT Corp. v. National Science Foundation*, 190 F.3d 269 (4th Cir. 1999), however, made no distinctions between depositions and document production. *Id.* at 275. Because the text of § 7 makes no distinction and no court has definitively answered this question, this Comment treats the analysis of subpoenas for depositions and document production as the same.

13. *Security Life Insurance Co.*, 228 F.3d at 870-71.

14. *Id.*

15. *Id.* at 870.

16. *Id.* at 871.

17. 190 F.3d at 276.

power of the arbitration panel to compel nonparties to appear 'before them'; that is, to compel testimony by nonparties at the arbitration hearing."<sup>18</sup> The court suggested that the logic for limiting these powers is clear: when parties agree to settle their disputes by arbitration, they exchange some procedural niceties for a more efficient dispute resolution.<sup>19</sup> For the Fourth Circuit, a "hallmark of arbitration—and a necessary precursor to its efficient operation—is a limited discovery process."<sup>20</sup> Although the Fourth Circuit stated that both the text and underlying policy goal of efficient dispute resolution suggest extremely limited subpoena powers for prehearing discovery in arbitration, the court also acknowledged that some discovery might be needed since "in a complex case . . . , the much-lauded efficiency of arbitration will be degraded if the parties are unable to review and digest relevant evidence prior to the arbitration hearing."<sup>21</sup> The court then suggested that in cases of "special need," which the court declined to define, some subpoena power might be warranted.<sup>22</sup>

## II. RESOLVING THE DISPUTE

To resolve the doctrinal dispute, there are several options of varying attractiveness, including more robust private law arrangements, a final judicial determination by the Supreme Court, and a statutory amendment.

Strong private law agreements could alleviate much of the difficulty regarding uncertainty about arbitrators' authority. When entering agreements, contracting parties could require that each side agree to provide all relevant information should one of the parties enter arbitration with any third party.<sup>23</sup> Under these circumstances, any dispute over the provision of information would be an issue of contractual, rather than statutory, interpretation.<sup>24</sup> Despite the institutional simplicity of this solution, however, it is largely unworkable because few parties would agree to be bound by contract terms

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18. *Id.* at 275.

19. *Id.* at 276 (citing *Burton v. Bush*, 614 F.2d 389, 390-91 (4th Cir. 1980)).

20. *Id.*

21. *Id.*

22. *See id.*

23. Parties can ensure a right to discovery if this is clearly outlined in their arbitration clause. *See Roseann Oliver & Frederic T. Knappe, Illinois Arbitrations: Pre-Hearing Discovery and the Right to a Full and Fair Hearing*, CHI. ASS'N REC., Sept. 1999, at 32, 32.

24. If this contract includes an arbitration clause, any disputed interpretation of that contract would fall under the terms of that arbitration clause.

subjecting them to potentially significant unforeseeable duties. One could argue that if all parties agree to assist in arbitrations, the savings to a given company when another assists in its arbitration proceeding would counterbalance the costs to that company of assisting in the current arbitration proceeding. While this argument has a theoretical appeal, in practice a given company enters only a small portion of the contracts made, and therefore may never need significant assistance. For a risk-averse contracting party, this uncertainty will likely be unacceptable.<sup>25</sup> Even a risk-neutral contracting party would be wary of agreeing to a contract term that, because of the uncertainty around it, would be difficult to price.

Alternatively, the Supreme Court could resolve the dispute among the circuits.<sup>26</sup> While this would unquestionably end the debate as to the correct interpretation of § 7, the predominant modes of statutory interpretation—textualism and purposivism—limit the Court. If the Supreme Court took a textual approach, it likely would hold similarly to the Third Circuit in *Hay* and narrowly interpret § 7. Alternatively, if the Court took a policy-minded purposivist approach, it might rely on what it has recognized as the “emphatic federal policy in favor of arbitral dispute resolution” and interpret the powers under § 7 more broadly.<sup>27</sup> These outcomes are fundamentally inconsistent with one another. A narrow interpretation runs counter to a recognized federal policy, but remains true to the text, while the broad interpretation runs afoul of the unambiguous textual meaning in deference to an overarching policy goal.

The idea that the Court would choose one set of values over another is not problematic; what is troubling is that it is the methods of statutory interpretation, rather than some reasoned approach, that would determine which values win.<sup>28</sup> When the method determines the outcome, there is always

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25. Cf. PAUL MILGROM & JOHN ROBERTS, *ECONOMICS, ORGANIZATION AND MANAGEMENT* 207 (1992) (“Efficient contracts balance the costs of risk bearing against the incentive gains that result.”). If parties cannot understand the scope of that risk, they cannot effectively balance it; thus they cannot make efficient contracts.

26. Recent commentary predicts that the Court will need to resolve the dispute, though there has been no analysis of how the Court should go about doing so. See Simpson & Kesikli, *supra* note 3, at 284.

27. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 631 (1985); see, e.g., *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213 (1985); *Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983) (describing the general policy to favor private arbitration agreements).

28. This is setting aside the debate over the judiciary’s authority to weigh competing values. For a very brief overview of this debate, see Walter Berns, *Government by Lawyers & Judges*, COMMENTARY, June 1987, at 17; and Richard A. Posner, *What Am I? A Potted Plant?*, NEW REPUBLIC, Sept. 28, 1987, at 23, 25.

some fear of circularity, that is, that the desired outcome will determine which method is used. Although the interpretation of any ambiguous statute is vulnerable to this critique, it is particularly problematic for § 7. By broadly construing arbitrators' abilities to issue subpoenas, and thus the judiciary's authority to enforce them, the Court would effectively engage in jurisdictional aggrandizement.<sup>29</sup> More problematically, the two approaches to statutory interpretation mentioned above create polar results, either extremely restrictive or permissive. The best resolution, however, is likely a more nuanced middle ground.<sup>30</sup> Unfortunately, the textualist and policy-minded methods of statutory interpretation cannot be combined to reach this optimal solution. Simply put, considering policy undermines textual analysis. Although an intermediate solution is preferable, the Court does not have the interpretive tools to reach this solution.

Because the Supreme Court is not well-positioned to resolve the dispute in a manner consistent with both statutory meaning and public policy, Congress should amend the statute so that a reasonable interpretation reflects reasonable policy. As the Third Circuit noted in *Hay*, several states have modified the Uniform Arbitration Act<sup>31</sup> so that arbitrators in those states have more expansive powers. Delaware, for example, modified the Act to state, "The arbitrators may compel the attendance of witnesses and the production of books, records, contracts, papers, accounts, and all other documents and evidence, and shall have the power to administer oaths."<sup>32</sup> Similarly, Pennsylvania added, "The arbitrators may issue subpoenas in the form prescribed by general rules for the attendance of witnesses and for the production of books, records, documents, and other evidence."<sup>33</sup> Congress could use similar language to modify § 7. Using such language unquestionably would clarify the powers granted by the FAA, but it leaves minimization of the

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29. Compare this to issues of judicial deference to agency interpretations. Commentators argue that courts should not grant *Chevron* deference to jurisdictional determinations by agencies. See, e.g., Ernest Gelhorn & Paul Verkuil, *Controlling Chevron-Based Delegations*, 20 CARDOZO L. REV. 989, 992-93 (1999).

30. The Court could certainly take the Fourth Circuit's approach, which was the most nuanced of the three cited above, but the text of the FAA does not contain an idea of "special need." *COMSAT Corp. v. Nat'l Sci. Found.*, 190 F.3d 269, 271 (4th Cir. 1999). Also, since the Fourth Circuit effectively punted and refused to define "special need," *id.*, the Court would be forced to define this term, which again, would look much like a job for the legislature.

31. UNIF. ARBITRATION ACT, 7 U.L.A. 1 (2005).

32. DEL. CODE ANN. tit. 10, § 5708(a) (1999).

33. 42 PA. CONS. STAT. ANN. § 7309(a) (West 2007).

potentially substantial third-party effects that a large discovery request might bring completely at the individual arbitrator's discretion.

Alternatively, Congress could create a reasonableness standard.<sup>34</sup> For example, the statute could be amended to include the sentence, "Similarly, these arbitrators may summon in writing any person to attend a deposition or produce any book, record, document, or paper prior to a hearing before the panel, if the request is reasonable." The wording is not critical, but the inclusion of a reasonableness requirement is essential.

Under this modified § 7, the procedure for obtaining a subpoena would be clear. Parties would request that the arbitrators subpoena specific documents or witnesses. If the arbitrators deemed this request reasonable, they would grant the subpoena. Several factors should be essential in the reasonableness inquiry. First, the arbitrators would consider the importance of the information sought. Arbitrators would be more likely to grant requests for critical documents, such as policy documents or claims forms, than for more tangential documents. Additionally, the relationship between the party and nonparty would be important. Arbitrators would be reluctant to authorize onerous requests if the party is "a mere bystander pulled into this matter arbitrarily," but not if it "is a party to the contract that is the root of the dispute."<sup>35</sup> Finally, the degree of burden placed on the nonparty would be critical. More burdensome requests would receive closer scrutiny than less burdensome requests. When these factors are considered in concert, arbitrators would authorize subpoenas for the most important, foreseeable, and not overly burdensome requests, thus ensuring that most essential information is available before the hearing, while protecting nonparties from substantial, unforeseeable requests.

This proposal is subtly different from the state modifications of the Uniform Arbitration Act mentioned above<sup>36</sup> and better protects third-party interests. Rather than grant widespread authorization to subpoena documents and witnesses, this proposed modification only authorizes reasonable requests. To avoid unreasonable requests, the state statutes rely solely on the discretion of the arbitrators, whereas the proposed modification creates a clear standard of review of the arbitrator's decisions. Under a modified § 7, any party to the arbitration or third party subject to the subpoena could challenge the

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34. For another proponent of allowing reasonable prehearing subpoenas, see Oliver & Knape, *supra* note 23. Note that these authors argue that some prehearing subpoenas are needed to ensure the fairness and efficacy of arbitration, but do not provide any criteria for determining which subpoenas to enforce. *Id.* at 36-37.

35. *Sec. Life Ins. Co. v. Duncanson & Holt, Inc. (In re Sec. Life Ins. Co.)*, 228 F.3d 865, 871 (8th Cir. 2000).

36. See *supra* notes 32-33 and accompanying text.

arbitrators' decision in court, and the statute would provide the judges with guidance on the scope of arbitrators' authority. Because of the clear standard of review included in the statute, courts and arbitrators would authorize some prehearing discovery, but sufficiently maintain the relevant third-party interests of not being overburdened by other parties' disputes.

Admittedly, drafting a reasonableness standard creates some additional difficulties. First, litigation would ensue as courts defined "reasonable." The courts likely would determine that "reasonableness" is dependent on the specific facts and circumstances of the dispute, which would require that all disputes over the reasonableness of a subpoena be brought before a court for that inquiry. Additionally, residual uncertainty as to the ability to obtain certain information in the prehearing phase would remain. This may discourage some parties from choosing arbitration as their preferred mode of dispute resolution. Finally, even a reasonableness standard could burden some nonparties with significant duties to testify or produce documents prior to an arbitration hearing.

Although these are valid criticisms, they are less problematic than they initially appear because structural similarities within the industries most in need of nonparty information will allow courts to define the contours of a reasonableness standard quickly. The insurance industry, for example, is one in which information from nonparties is critically important. Although the insurance industry is diverse, there are structural similarities among simple automobile insurance, more complex health insurance, and very complex commercial catastrophic insurance; in all areas of the industry, critical information often resides with reinsurers or third-party claims administrators. This similarity eases the implementation of a reasonableness standard because certain relationships, such as insurer to reinsurer, or policyholder to claims administrator, will be defined as either a reasonable or unreasonable basis for discovery requests. In most cases, parties will accept that their relationship is structurally similar enough to the relationship in the initial case and comply with the subpoena. Certainly, some will contest the subpoenas, but frequently these will be cases with particularly burdensome requests or tenuous relationships. For the majority of cases, it will be less costly to comply with a request to produce documents than to contest the subpoena in court, especially when the relationship in question has already been defined as sufficiently close to merit enforcing a subpoena. Because the courts will quickly draw the boundaries of the reasonableness standard, the costs of implementing such a standard will decrease, as will the uncertainty among contracting parties as to the ability to obtain critical documents from nonparties. While even requests deemed reasonable may place significant burdens on some nonparties, this is largely unavoidable. One consolation is that, with a well-defined standard,



parties entering agreements to fill some role that would subject them to arbitration discovery subpoenas will have advance knowledge of this fact and will price the expected cost of complying with arbitration-based discovery requests into their contracts.

## CONCLUSION

Because the current wording of § 7 is unclear, the fairness and efficacy of arbitration is in jeopardy. Without a lower-cost, yet effective, alternative to litigation, parties may be reluctant to enter relationships that could require dispute resolution. Private law arrangements could alleviate the consequences of this ambiguity, but the artful drafting and negotiating required for this outcome renders it an unlikely solution. Alternatively, the Supreme Court could resolve the dispute among the circuits, but its best interpretive tools cannot reach the nuanced, intermediate solution that is needed. To solve this problem and secure arbitration's place as the lower-cost alternative to litigation, Congress should take action to clarify the scope of arbitrators' authority to issue prehearing subpoenas. To balance optimally the interests of the parties inside and outside the arbitration proceeding, Congress should authorize arbitrators to issue subpoenas for reasonable prehearing discovery.

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